Audit's
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MONTHLY NEWS ANALYSIS OF SECURITIES OF REAL ESTATE INVESTMENT TRUSTS

Realty Trust Review

MARCH 1970

NON-STOP LISTING PARADE BOOSTS GROWTH POTENTIAL

Midland Mortgage Investors and Associated Mortgage Investors joined the American Stock Exchange list March 2 and 3 respectively as the latest additions to what promises to be the longest listing parade in years. They were the tenth and eleventh real estate investment trusts to join either the NYSE or ASE rolls since last summer, and another two trusts—First Mortgage, and First Union Real Estate—have applications pending. Since only seven trusts enjoyed listed trading before mid-1969, the listed market for trust securities have effectively tripled since last summer.

COMPLIMENTARY

Doubtless even more listings are on the way as a great many of the 27 realty trusts formed in the past year will seek qualification as quickly as they can. Since the bulk of new trusts are sponsored by existing financial or industrial companies they may qualify for waivers from the exchanges' normal one year of operation requirement. In short, you'll be hearing a great deal more about the trusts as the markets for their securities move from the pink sheets onto the NYSE and ASE.

Two Special Benefits for Trusts in Listing

A number of very large and successful companies—including the majority of bank and insurance company stocks—have studiously avoided the listed markets, claiming that the investor's ability to shop several brokerage firms making markets in a stock results in better pricing. And the growth of over-the-counter third markets and computerized services for block transactions to serve institutions underscores the desirability of off-board trading in some situations. Some have gone so far as to suggest that listed markets may in time become vestigial markets for small investors while the off-board markets handle a much larger volume of block transactions for institutions.

For the present, however, we believe there's no doubt that a listing is beneficial to both companies and investors. Most of the advantages are obvious: prompt reporting of prices of actual transactions, narrower spreads between bid and asked prices, and prompt disclosure of material events to investors. But the real estate trusts have two special advantages in listing.

Visibility. Listing puts a trust's securities before a national and international investment community like no other single act. Since Congress approved the special tax exemption which is the core of trust operation nearly a decade ago in September, 1960, the trusts have lived in relative obscurity without the broad investor support that trust boosters had envisioned. That law extended the same type of conduit tax treatment enjoyed by mutual funds to the trusts in the hopes that trusts could attract large sums of capital into realty.

But at the beginning of 1969, total equity capital of the major operating trusts was less than $1 billion. Today the trusts have doubled and then some in virtually every measure—assets, equity, and market value.

Liquidity. Listing generally provides the greater liquidity necessary to attracting larger institutional purchasers. Most trusts have had thin OTC markets which have resulted in limited trading activity and some sharp price swings on occasion. Listing is no panacea but the heightened visibility does tend to attract the larger trading volume that enhances liquidity. In the final analysis liquidity is going to depend upon the financial strength of the specialists assigned to a stock on an exchange. Since NYSE specialists are generally better capitalized than ASE units, we would expect then that some of the new large trusts would bypass the ASE and wait until they can get Big Board clearance before listing.

And Then, Higher Market Prices to Grow By

But the real incentive to listing appears to be the

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higher market value relative to book value generally enjoyed by the listed trusts. Since trusts may not retain earnings, the ratio of market value to book value becomes crucial in assessing a trust's growth potential.

Simply put, a high ratio lets a trust buy other assets (either dollars for a mortgage trust or book equity for an ownership trust) cheaper than a trust with a low ratio can buy those same assets. This is the essence of equity leverage, and it makes little difference to us whether a trust purchases dollars with its shares (through issuance of convertible debentures) or equity in a building (through direct issuance of shares). Sure, this sounds like the old conglomerate game all over again, with hoked up earnings to hypo stock prices so sound, low P/E companies could be bought with cheap paper. But there's a big anchor to windward in the dividend trusts must return to shareholders, and we think that this dividend yield will tend to keep the trusts from selling at sky-high P/Es.

Audit's tabulation of 17 listed trusts and 22 OTC trusts (below) indicates that the market/book value ratio is significantly higher for listed trusts, with listed trusts having market value 231% of book value while the ratio for unlisted trusts is less than half at 113%. If Continental Mortgage Investors, the trust with the highest valuation ratio is omitted, the listed trusts still weigh in at 177% of book value.

The implication is that the major unlisted trusts

THE MARKET VALUE STORY: LISTED VS. UNLISTED TRUSTS

Trust	--(Million $)-- Equity	Market Val.	Mkt./ Equity %
NYSE			
Continental Mtg.	$38.6	$288.5	746%
Diversified Mtg.	95.0	156.6	165
Federated Mtg.	25.0	17.3	69
ASE			
Amer Cent. Mtg.	24.4	25.3	104
Amer Realty	6.6	9.2	139
Assoc. Mtg	16.0	22.1	138
Franklin Realty	9.8	8.1	82
Guardian Mtg.	11.6	13.6	505
Kavanau Trust	3.2	16.3	505
Midland Mtg.	19.0	21.7	115
National Realty	12.7	18.0	142
N. Amer. Mtg.	16.8	50.1	298
Prudent Resrs.	13.8	77.0	558
RE Trust Amer	29.6	29.6	100
Realty Inc. Trust	14.5	15.2	105
Security Mtg.	18.0	64.7	360
Sutro Mtg.	25.4	29.5	116
U.S. Realty	18.3	43.5	238
TOTALS	$392.2	$906.3	231

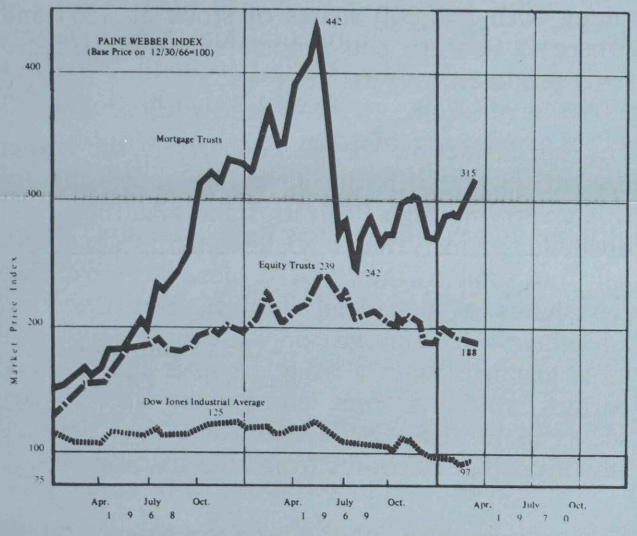
Trust	--(Million $)-- Equity	Market Val.	Mkt./ Equity %
OTC			
City Inv. Mtg.	$62.9	$56.2	89%
Denver RE Inv.	8.4	8.5	102
Fidelity Mtg.	32.2	34.2	106
First Mtg. Inv.	44.8	96.0	214
First Union RE	23.8	29.6	124
Fraser Mtg. Inv.	17.4	21.5	123
Galbreath Mtg.	16.3	17.5	107
General Mtg.	13.6	12.0	88
Greenfield RE	7.6	8.5	111
Hubbard RE Inv.	92.5	87.0	94
Larwin Mtg. Inv.	37.3	36.3	97
Lomas & Net. Mtg.*	25.5	36.7	144
Medical Mtg.	29.1	36.9	127
Mtg. Inv. Group	45.5	52.1	115
Mtg. Tr. Amer	61.2	59.5	97
Mutual REIT	10.0	5.7	57
National Mtg.	5.9	6.1	104
Penn. REIT	9.8	12.9	131
Republic Mtg.	30.6	36.1	118
Universal Inv.	6.2	2.5	41
Washington RE Inv.	2.5	8.4	340
Western Mtg.	8.8	6.5	73
Wisconsin REI Fund	2.8	8.5	301
	$569.2	$642.6	113

679.2

$1,585.5 Tot.

* Not included in tabulations

would have a market value of about $1 billion if listed. Obviously other factors are at work here: listed trusts tend to be the largest and most successful, hence most esteemed by investors. And trust pricing is a subtle weighing of earnings, cash flow, and dividends instead of a mechanical application of ratios to book value. But overall, the higher market value for listed trusts is the most compelling reason the listing parade will march on.



WHERE WE STAND: MORTGAGE TRUSTS RECOVERING SLOWLY Mortgage trust shares are rallying from the extremely depressed conditions of last July while equity trusts have been slowly drifting downward since May 1969. These divergent trends are pictured by the trust indexes prepared by the investment banking firm of Paine, Webber, Jackson & Curtis.

In the Paine, Webber Index, prices of the mortgage and equity trust series along with the Dow-Jones Industrials are all converted to an index with Dec. 31, 1966 as the base of 100. This method permits direct comparison of trusts with the blue chip DJI. The mortgage trust index clearly shows that mortgage trusts shares literally fell out of bed last spring when they plunged 45% from a high reading of 442 to a low of 242 in a brief eight weeks. Since then share prices have traced a generally upward sawtooth pattern despite the offering of $737 million trust shares since last summer. While we are not chartists, the graph suggests firming investor support for the mortgage trusts. In view of the low P/Es prevailing for most mortgage trusts, we regard selected trusts as excellent commitments now.

Contrariwise, ownership trusts have been gently sliding downhill since last May under pressure of rising interest rates which essentially depress the value of cash flow from their properties. Since we expect gradual monetary easing to become apparent within two months, equity trust shares at about 21% below their peaks represent intriguing commitments to windward.

While the Paine, Webber Index separates trusts into two separate mortgage and equity categories, RTR will dispense with this demarcation for most purposes. Why? Simply because the number of trusts wishing to play both sides of the investment street through combination investment policies is growing: U.S. Realty Investments, B.F. Saul, and National Investors are the most prominent examples among the established trusts, but some newcomers like the pending Connecticut General Mortgage and Realty Investments are joining the crowd. In short, the day of easy pigeonholing of trusts is fading fast.

AND NOW, ENTER THE LIFE INSURANCE GIANTS Connecticut General Insurance Corp.'s pending move into realty trust management is the first robin in what could become the biggest migration of the 1970's. While much attention has been focused of late on the life companies' big push into mutual funds—a move that began in the late 1950s—the word on Wall Street is that the big life companies are poised to leap into realty trust operation, and Mutual of New York has followed by registering a $100 million package of **MONY Mortgage Investors.**

Hence ConGen's registration of a proposed $100 million offering by Connecticut General Mortgage and Realty Investments (half equity, half convertible debt) has all the implications of the first successful test of an atom bomb explosion. To date life companies have sponsored only two trusts—American Century Mortgage, sponsored by American Heritage Life Insurance ($47 million assets) and Fidelity Mortgage Investors, by a group of life companies controlled by George Washington Corp. Holding Co. ($218 million assets).

In contrast ConGen has $5.3 billion assets to give authority to its move. Among other things, that kind of financial muscle can go a long way toward persuading underwriters to assure a successful offering. For another, a life company gets enough investment proposals at all times to assure a full portfolio for even a major trust. Since we view

origination muscle as one of the two essential elements for successful trust operation, (leverage is the other), then the ConGen trust certainly would be halfway up the ladder already.

ConGen has always been real estate oriented. It is a 50% owner of the widely publicized new town of Columbia outside Baltimore with the Rouse Co., and its real estate holdings amount to $169 million. Last year ConGen paid $27.6 million for three office towers in New York City and Cleveland, and during 1969 also formed subsidiary ConGen Properties to operate as a realty developer, owner and equity participant. Initial projects include a $100 million, 6,000-unit apartment complex in Columbus, Ohio.

ConGen's new trust will invest initial proceeds in construction and development loans but intends to put most funds ultimately into long-term mortgage loans or equity investments. It will stress combination investments such as land purchase and lease-back, leasehold mortgage financing, and net lease financing which may give the trust a share in possible capital appreciation. Trust officers and managers include Bruce P. Hayden, president, and Maynard C. Bartram, president and secretary for the mortgage and real estate department of Connecticut General Life.

But since the insurance companies have been major purchasers of the convertible securities that have recently permitted non-insurance trusts to leverage their equity, there's a natural question of who will buy the debt issues of a Connecticut General trust, or any other trust for that matter. The answer will, we believe, determine the long-term viability of the insurance companies' move into realty trusts.

NEW TRUST CONVERTS: GOOD BUY OR PASS? For the first time investors are getting to choose between a variety of convertible bonds issued by trusts (principally of the mortgage variety). Until the first of this year, most trusts placed their converts privately with institutional investors and hence public trading markets never developed in these securities.

Now that has changed, with Continental and First Mortgage, the grandaddies of the mortgage group, offering packages of converts in recent weeks. Moreover, the major rating agencies like Standard & Poor's have begun assigning ratings to these debentures for the first time. S&P rated Continental's $85 million 6¼% issue BBB and First's $35 million 6¼% debentures BB. Incidentally, S&P will insist upon a five-year operating record before rating trust convertibles so that the newer trusts won't be assigned ratings for some time. However, the race is on for funds with which the second generation mortgage trusts can leverage their equity and we fully expect to see a goodly number of new trust converts. Guardian Mortgage Investors sold a $15 million issue of 8% convertibles Feb. 24 (along with 200,000 shares of stock at $25) and American Century and Associated Mortgage registered proposed convertible issues.

The big attraction to the converts is the higher current yield, with the advantage increasing for trusts carrying high P/E ratios and resulting lower dividend yields. Hence yield-conscious accounts will find some of the converts more attractive than the shares of beneficial interest. But the yield advantage will likely last only a couple of years in most instances since a rising earnings and dividend pattern would at some point make the ordinary shares more attractive. Hence some trust converts actually sell at discounts from conversion parity.

Since convertibles imply dilution of share earnings, the beneficial shares generally will be valued on the basis of fully diluted earnings in cases where overhanging conversion is large. However, since dividend payouts are based on undiluted earnings, the crossover point at which conversion becomes more attractive for debenture holders will have to be watched closely. We believe the trust converts make the most sense for income accounts rather than for their gains potential.

Below we have summarized data for some newer converts. We would stick with issues of the established trusts such as Continental and First because their recent financings materially broaden their capital base. CMO's equity and subordinated debt now total $203 million and First weighs in at $92.4 million. Full conversions and exercise of warrants would boost book value to $9.67/sh for CMO and $15.56 for First. Guardian, Associated, and U.S. Realty have the appeal of a lower P/E ratio which offers some upside potential on the bonds.

		Conv. - Bond - @	prc.	yld.	- Stock - prc.	yld.	Conv. prem.
Amer. Realty	7s1984	13	78	9.0%	9¾	7.2	4.0%
Assoc. Mtg.	6½s'83	22	125	5.2	28	4.2	-3.3
Continental	6¼s'90	22¼	101½	6.2	22	3.3	2.7
Diversified	6½s'89	23	126	5.2	30	4.8	-3.4
First Mtg.	6¾s'85	24	110	6.1	27	4.9	-2.2
Franklin Rl.	7s1989	10	91½	7.7	9	7.1	1.7
Guardian Mtg.	8s1985	25	107	7.5	27¼	8.8	-2.7
Pennsylvania	6¾s'84	14*	83	8.1	12	6.7	-3.2
U.S. Realty	5¾s'89	25¼	78¼	7.3	20	6.0	1.2

*Increases to $17 on Feb. 14, 1973